

I N T R O D U C T O R Y S E C T I O N



December 10, 2008

TO THE CITIZENS, GOVERNOR AND MEMBERS OF THE IOWA GENERAL ASSEMBLY

In accordance with Iowa Code Section 8A.502(8), we are pleased to submit the Comprehensive Annual Financial Report (CAFR) for the State of Iowa for the fiscal year ended June 30, 2008. As required by State statute, this report has been prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for governments as promulgated by the Governmental Accounting Standards Board (GASB).

The Department of Administrative Services and the Department of Management are responsible for both the accuracy of the presented data, and the completeness and fairness of the presentation. We believe the information presented is accurate in all material respects and the necessary disclosures have been made which enable the reader to obtain an understanding of the State's financial activity.

The State's system of internal controls over assets recorded in the accounting system have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded against unauthorized use or disposition, and that financial records from all appropriate sources are reliable for preparing financial statements and maintaining accountability. The concept of reasonable assurance recognizes the cost of internal controls should not exceed the benefits likely to be derived from their use. To monitor the adequacy of internal controls, the Auditor of State reviews internal control procedures as an integral part of departmental audits.

The Auditor of State is required by Chapter 11 of the Code of Iowa to audit annually all departments of the State. The accompanying basic financial statements of the State of Iowa have been audited by the Auditor of State in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in "Government Auditing Standards", issued by the Comptroller General of the United States. His report appears elsewhere herein. In addition, the Auditor of State conducts a single audit under the requirements set forth in the Single Audit Act of 1984, the Single Audit Amendments of 1996, and OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations". That report is issued separately.

GAAP require that management provide a narrative introduction, overview and analysis to accompany the basic financial statements in the form of the Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A, and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditor's Report.

PROFILE OF THE GOVERNMENT

The State of Iowa was admitted into the Union as the 29th state in 1846. Iowa is a midsize state with a mid-continent location. It covers 55,869 square miles, making it the 25th largest state in the United States. The Mississippi River carves out Iowa's eastern border, while the flow of the Missouri and Big Sioux Rivers form the western border. Iowa has a population of 3.0 million.

In Iowa, government power is distributed among three branches. The Legislative branch creates laws that establish policies and programs; the Executive branch carries out the policies and programs created in the laws; and the Judicial branch resolves any conflicts arising from interpretation or application of the laws. The Executive branch agencies are the Governor, Lieutenant Governor, Secretary of State, Treasurer of State, Secretary of Agriculture, Attorney General and Auditor of State, as well as 30 agencies lead by appointed State officials. The Legislative branch is comprised of two houses, a 50 member Senate and a 100 member House of Representatives. The Judicial branch is presided over by the Iowa Supreme Court, which is led by the Chief Justice of the Supreme Court.

The State provides a range of services such as education, health and human services, highway maintenance and construction, natural resources and agriculture management, law enforcement, public safety, and economic development programs.

This report includes all of the fund types, departments and agencies of the state, as well as the boards, commissions, authorities, and universities for which the State is financially accountable. Component units also included in the report are the Iowa Finance Authority, Iowa Higher Education Loan Authority, Iowa Agricultural Development Authority, Iowa State Fair Authority and Universities Foundations. The reader is directed to Note 1.B in the Notes to the Financial Statements for a more complete description of the factors used to define the reporting entity.

State Budget and Budgetary Controls. The annual budgetary process serves as the foundation for the state's financial planning and control. Each year state departments submit budget requests to the Governor's Office by October 1. The State's budget is prepared by the Governor on an annual basis and is required to be submitted, along with proposed appropriation bills, to the General Assembly by the first of February prior to the new fiscal year. The General Assembly approves appropriation bills which establish spending authority for the upcoming fiscal year. The Governor has the ability to approve, veto or item veto appropriation bills as they are presented to him.

Departments may request revisions to allotments, appropriations transfers, or supplemental appropriations. The Department of Management approves revised allotments within an appropriation, subject to the Governor's review. The Governor and the Department of Management approve all appropriation transfers. The General Assembly and the Governor act on supplemental appropriation bills in a manner similar to original appropriations. Appropriations lapse at fiscal year-end and all unencumbered or unobligated balances revert to the state treasury, unless otherwise provided.

All claims presented for payment must be approved by the appropriate department. The expenditure must be for a purpose intended by law and a sufficient existing and unexpended appropriation balance must be available. Budgetary controls are incorporated into State accounting systems. The annual budget of the State is established through separate appropriations to individual departments for specific purposes, special outlays and/or operating expenditures. Budgetary control is essentially maintained at the departmental level except for certain grant and aid programs where control is maintained at the program level.

ECONOMIC CONDITION AND OUTLOOK

National Economic Outlook 2008-2009

Recent issues in the credit market concerning sub-prime mortgage lending and the housing market problems have led people to believe the national economy is in recession. The Federal Reserve lowered the federal funds rate to 1.00 percent and the discount rate to 1.25 percent in October 2008.

Due to these events, the U.S. Bureau of Economic Analysis (BEA) released estimates that economic growth decreased 0.3 percent in the third quarter of 2008, after increasing 2.8 percent in the second quarter. According to the BEA, the decrease in the third-quarter real Gross Domestic Product (GDP) growth primarily reflected negative contributions from personal consumption expenditures, residential fixed investment, and equipment and software. However, imports have decreased which positively impacted the real GDP.

The outlook of the national economy, according to experts, is a sluggish pace for the near future. The widespread state GDP growth in almost all the states in 2006 has tapered off in 2007 and 2008, due to the mortgage credit crisis, the housing slump, and highly volatile world oil prices. Moody's Economy.com is expecting negative growth of 2.2 percent in the fourth quarter of 2008 and negative 1.0 percent the first quarter of 2009, with GDP staying even for the second quarter and increasing 2.2 percent in the third quarter of 2009. The unemployment rate is currently its highest rate since the 1990s at 6.5 percent. Core Consumer Price Index (CPI) inflation is expected to increase about 0.18 percent by the end of 2008. This would predict a 2.5% drop from 2007 to 2008 in CPI. Cars, apparel and transportation were the main contributors to the CPI decrease.

State and Local Economy

Iowa's economy is supported by a diverse mixture of industry, agriculture, services and government employment. For example, eleven years ago (1997), the agricultural industry accounted for 6.5 percent of Iowa's gross domestic product by state, finance and insurance 8.0 percent, real estate, rental and leasing 8.5 percent, and professional and technical services 3.2 percent. By 2007, the shares of Iowa's gross domestic product had changed to 6.0 percent for the agricultural industry, 10.7 percent for finance and insurance, 8.3 percent for real estate, rental, and leasing, and 3.2 percent for professional and technical services.

The agricultural sector remained relatively stable during the last seven years. Approximately 93 percent of the land area in the state is in farms. The Iowa Department of Agriculture and Land Stewardship reported in 2006, Iowa led the nation in the production of pork, corn, soybeans and eggs. Iowa's total cash receipts for farm commodities in 2007 totaled \$19.7 billion. According to the National Agricultural Statistics Service (NASS), this is obtained through 47 percent livestock and 53 percent crops. The state ranks third in the country, behind California and Texas. Iowa produces more ethanol per year than any other state. Currently the 30 ethanol plants in Iowa produce well over 2 billion gallons annually. The Federal Reserve Bank of Chicago reports the value of farmland in Iowa increasing by 15.0 percent from July 1, 2007 to July 1, 2008. For the same period last year, the value of farm land increased by 18.0 percent.

Farmland Values. The most recent survey of area bankers indicates that farmland values continue to rise. In the August 2008 survey, Iowa farmland values had risen 3.0 percent from April to July 2008. This was tied for second for quarterly growth in land values in the Federal Reserve Bank of Chicago District behind Indiana which experienced a 6.0 percent growth rate. Iowa had an annual growth rate of 15.0 percent.

Personal Income and Per-Capita Personal Income. The University of Iowa Institute for Economic Research's latest outlook is for personal income in Iowa to grow by 5.3 percent in 2008 and 5.0 percent in 2009. According to the BEA, in the last three quarters of 2007-08 fiscal year, Iowa's personal income, seasonally adjusted, grew at a rate of 1.38 percent, 0.91 percent and 1.56 percent respectively, which was similar to the nation as a whole, with personal income growth of 1.19 percent, 0.79 percent and 1.79 percent, respectively. Iowa's average per-capita income has been trending upward since the mid 1980's. In 2007, Iowa's average per-capita income, as reported by BEA, was \$34,796. The average per-capita income in the nation was \$38,564.

Employment. Over the past 10 years, Iowa's unemployment rate has been between one and two percentage points below the national average. The seasonally adjusted unemployment rate for Iowa in September 2007 was 3.8 percent, and the rate for September 2008, was 4.2 percent. In September 2008, there were 1,685,300 employed Iowans, compared to 1,663,400 employed Iowans in September 2007. Iowa has a greater percentage of labor force employed compared to the nation as a whole and also has a larger percentage of its population actively participating in the labor force. While Iowa's personal income lags that of the nation, its high levels of employment help maintain median household income at levels only slightly below the national average. In the 2007 American Community Survey (ACS) data, Iowa's median household income was \$47,292, in 2007 inflation-adjusted dollars. The national median household income was reported at \$50,740, in 2007 inflation-adjusted dollars.

Manufacturing. Iowa's manufacturing employment averaged 229,500 for 2007, which was a slight drop from the sector's highest level of employment since the late 1990's achieved in 2006. Currently, durable goods products account for about 61.7 percent of manufacturing employment, and also account for most of the growth in the industry. Due to the nationwide slowdown in homebuilding, manufacturing employment is expected to decrease by about 500 in 2008, and another 1,000 in 2009.

Exports. The rise in exporting industries has been an important factor in Iowa's economic growth since the 1990's. Growth in exports of industrial machinery, instruments and measurement devices, electronics, specialized transportation equipment, chemicals and pharmaceuticals, and processed food products have helped diversify Iowa's economy. When combined with traditional farm commodities and livestock, total exports from Iowa have continued to increase. Specifically, the last ten years have seen steady and strong growth. From 2006 to 2007 Iowa exports increased 14.1 percent and accounts for about 0.8 percent of the total exports from the United States.

Mexico continues to be Iowa's second best trading partner and has replaced Japan and Germany as the second leading export country, partially due to the increase of value-added products shipped to Mexico. Canada continues to maintain the top spot. Iowa's record level of exports has been fueled by large percentage increases in corn, soybeans and flours.

Gross Domestic Product. The gross domestic product is the U.S. Commerce Department's measure of the value of all goods and services produced in Iowa each year. In 2007, Iowa's real gross domestic product by state was \$107.0 billion, which reflected a 1.7 percent-growth over the previous year. Contributing to this change were agriculture, forestry, fishing and hunting (10.15 percent increase), utilities (10.02 percent increase), information (6.52 percent increase), professional and technical services (5.67 percent increase), administrative and waste services (5.56 percent increase), and management of companies and enterprises (4.87 percent increase), among others. The nation's real gross domestic product (\$11.47 trillion) grew by 2.0 percent between 2006 and 2007.

Nonagricultural Economy. Over the past 15 years, significant changes have occurred in the mix of nonfarm wage and salary employment. While payroll jobs in Iowa grew by 0.4 percent, jobs in the business services sector decreased by 0.6 percent, and the financial services sector grew by 0.5 percent. Conversely, manufacturing jobs decreased by 1.0 percent.

Financial Policies

The Governor and General Assembly have statutory responsibility to balance the budget.

- Spending is limited to 99.0 percent of adjusted revenues, 95.0 percent of any new revenue implemented in a fiscal year, and any carry-over from the previous year.
- The Governor and the Legislature are required to use the revenue estimates agreed to by the December Revenue Estimating Conference or a later estimate, if it is lower, as a basis to determine the General Fund budget for the following year.
- Two reserve funds were created; the Cash Reserve Fund and the Economic Emergency Fund. Expenditures from these funds are limited by statute for nonrecurring emergency expenditures.

MAJOR INITIATIVES AND ISSUES

Student Achievement/Teacher Quality. During the 2008 session, the Legislature continued the commitment to Student Achievement and Teacher Quality by including an additional \$75 million appropriation toward this program in fiscal year 2009 on top of \$70 million appropriated in fiscal year 2008. This will provide additional funding to local schools to increase teacher salaries and move toward the goals of increasing student achievement.

Preschool Initiatives. During the 2008 session, Governor Culver and the Legislature continued work on preschool legislation. Included in these policies are an additional \$17.1 million to support preschool development on top of the \$15 million which was appropriated in fiscal year 2008. This will provide substantially greater resources for preschool to better prepare Iowa's youngest children to learn.

Alternative Energy Initiatives. Governor Culver recommended and the Legislature passed \$25 million for the second year of the \$100 million Iowa Power Fund to maintain leadership in the development and production of renewable energy and alternative fuels.

Prison Construction. In an effort to modernize the state's prison infrastructure, Governor Culver recommended and the Legislature approved funding in fiscal year 2009 of \$206.1 million from revenue bonding to rebuild the state's maximum security prison, rebuild and expand the state's prison for women and expand community based corrections facilities.

AWARDS AND ACKNOWLEDGEMENTS

Certificate of Achievement. The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Iowa for its comprehensive annual financial report for the fiscal year ended June 30, 2007. This was the fifteenth consecutive year the State of Iowa has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgment. The preparation of this report on a timely basis requires the collective efforts of numerous finance personnel throughout the State and is made possible only with the cooperation and support of the Executive, Legislative, and Judicial branch agencies, universities, and component units of the State.

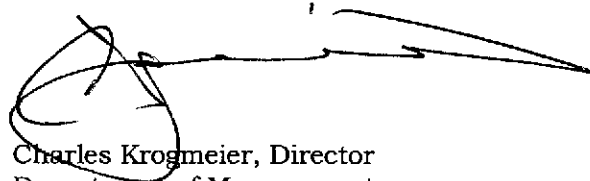
This report could not have been accomplished without the professionalism and dedication of the staff in the Department of Management, the State Accounting Enterprise within the Department of Administrative Services, the Auditor of State's Office, and the financial and management personnel throughout State government.

This report, issued for the twentieth consecutive year, continues our commitment to the citizens of the State of Iowa, the Governor, the Legislature, and the financial community, to maintain our financial statements in conformance with the highest standards of financial accountability.

Respectfully submitted,



Ray Walton, Interim Director
Department of Administrative Services



Charles Krogmeier, Director
Department of Management

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Iowa

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2007

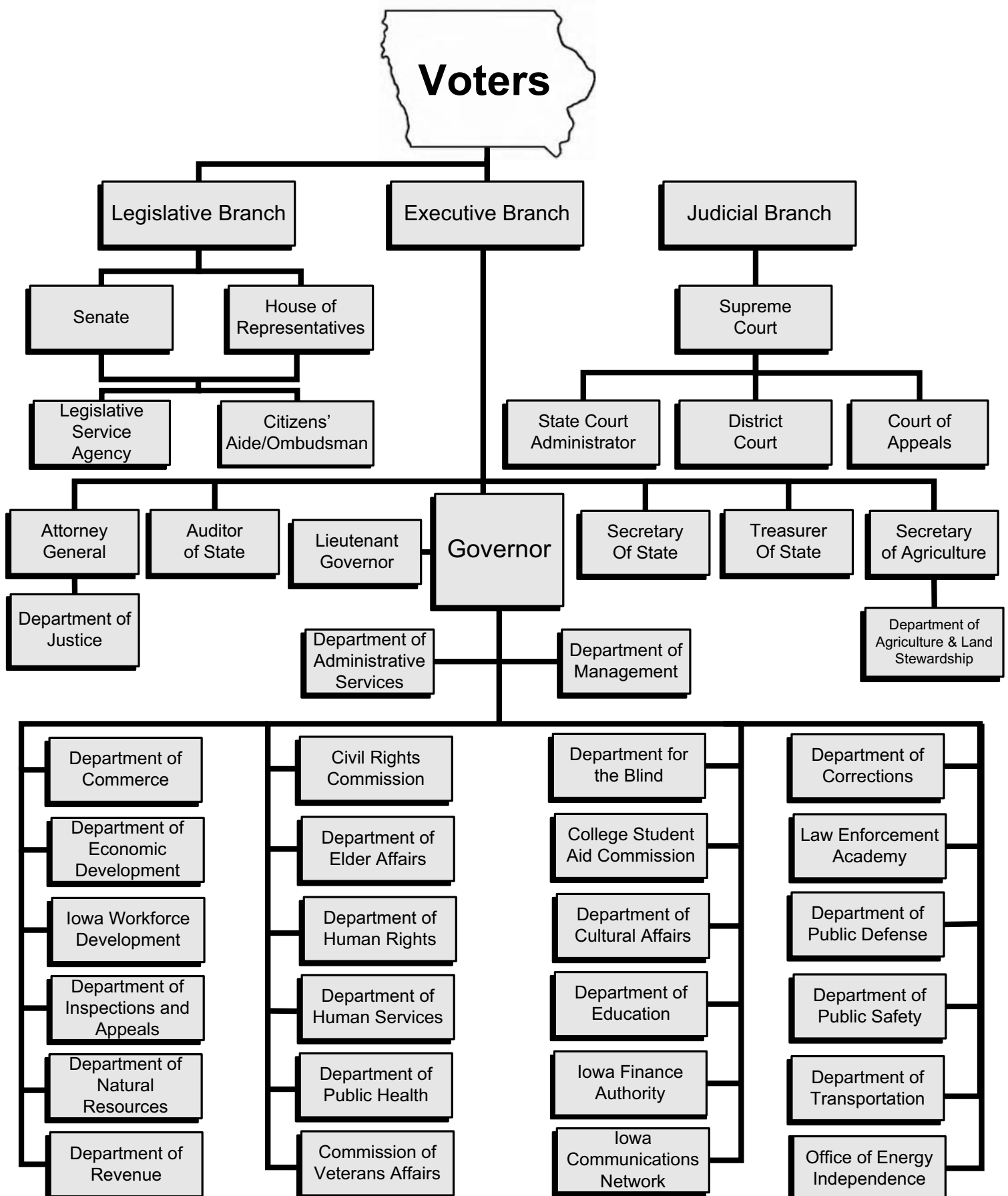
A Certificate of Achievement for Excellence in Financial
Reporting is presented by the Government Finance Officers
Association of the United States and Canada to
government units and public employee retirement
systems whose comprehensive annual financial
reports (CAFRs) achieve the highest
standards in government accounting
and financial reporting.



President

Executive Director

State of Iowa Organizational Chart



P R I N C I P A L O F F I C I A L S

Elected Officials

GOVERNOR - **Chester J. Culver**
LIEUTENANT GOVERNOR - **Patty J. Judge**
SECRETARY OF STATE - **Michael A. Mauro**
AUDITOR OF STATE - **David A. Vaudt**
TREASURER OF STATE - **Michael L. Fitzgerald**
SECRETARY OF AGRICULTURE - **William H. Northey**
ATTORNEY GENERAL - **Thomas J. Miller**

Legislative Branch

PRESIDENT OF THE SENATE - **John P. Kibbie**

SPEAKER OF THE
HOUSE OF REPRESENTATIVES - **Patrick J. Murphy**

Judicial Branch

CHIEF JUSTICE OF
THE SUPREME COURT - **Marsha K. Ternus**